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German Tax and Legal News

Lower house of parliament finalizes Brexit Tax Implementation Act

Law includes measures to protect taxpayers from disadvantageous consequences resulting from Brexit.

On 21 February 2019, Germany's lower house of parliament (Bundestag) voted to approve a law (Brexit Tax Implementation Act) that will introduce tax measures to protect German taxpayers from potential negative consequences of the UK leaving the EU.

The UK is scheduled to withdraw from the EU on 29 March 2019. This withdrawal date can be extended only by unanimous approval of the EU member states. A draft withdrawal agreement that includes a transition period, and further details regarding the relationship between the UK and the EU during the transition period and following withdrawal, has been approved by the EU member states, but still awaits approval by the UK. Whether the UK will approve this agreement is unclear, and it is possible that the withdrawal period may be extended beyond the original 29 March 2019 deadline.

Assuming that the UK leaves the EU without a transition period or a withdrawal agreement ("hard Brexit"), the UK will be treated as a country outside of the EU and no longer will be able to benefit from certain German tax measures that are available only to EU-resident taxpayers. Withdrawal also could have the consequence that certain tax-neutral reorganizations/transfers that take place before Brexit and that require the involvement of EU resident companies or permanent establishments (PEs) following the reorganization/transfer would become taxable on a retroactive basis. To mitigate the most disadvantageous tax consequences resulting from Brexit, the law clarifies that Brexit itself will not constitute a "harmful event" for purposes of certain German tax law provisions. (Harmful events may result in immediate taxation or other unfavorable tax consequences.)

The measures included in the final version of the law approved by the lower house generally are identical to the measures included in the first draft of the law that was published by the Ministry of Finance (MOF) on 9 October 2018 (see GTLN dated 11 October 2018) and approved by the upper house of parliament on 15 February 2019:

- The recognition of capital gains from the transfer of an asset out of Germany to a PE of the same taxpayer in the EU may be spread over a five-year period. However, if the asset no longer is part of a PE located in the EU (i.e. if the asset is transferred out of the PE, or if the PE no longer is located in the EU), the capital gains would become taxable immediately. The law clarifies that Brexit will not constitute a harmful event for purposes of the five-year period and that it will not lead to immediate taxation of the capital gains triggered by the asset transfer.
- If the statutory seat or the place of management of a corporation is migrated out of the EU and, as a result, the corporation no longer is subject to unlimited tax liability in an EU member state, under German tax law, this is considered a liquidation of the corporation that generally would result in capital gains taxation. The new law includes a provision that clarifies that Brexit alone will not trigger this result, and that no capital gains taxation will apply due to Brexit.
- Share-for-share exchanges and certain asset contributions in exchange for (newly issued) shares are possible on a tax-neutral basis, provided the entity that receives the shares/assets is an EU resident company. The shares received in the tax-neutral transaction are considered "tainted" for a seven-year period during which, inter alia, the receiving entity must qualify as an EU resident entity. The law clarifies that Brexit will not constitute a harmful event that will result in retroactive taxation of the share-for-share exchange or asset contribution. If the transaction is carried out on a tax-neutral basis before Brexit, the withdrawal of the UK from the EU will not trigger the "clawback" provision that would make the transaction taxable on a retroactive basis. All other conditions that apply during the seven-year period, however, still will need to be fulfilled.

- For individuals, the income tax that becomes due under certain circumstances as a result of a transfer of residence out of Germany, based on the application of the German Foreign Tax Act, may be deferred if the individual transfers his/her residence to another EU member state and becomes subject to unlimited tax liability in that member state. The law includes a provision that clarifies that Brexit will not end the tax deferral for residence transfers that occurred before Brexit.
- The payment of the capital gains tax resulting from the sale of specific assets may be spread over a certain period of time without interest being assessed, provided the gains are reinvested in certain other assets of the same taxpayer in Germany or another EU member state. The law clarifies that a reinvestment in the UK still will qualify for tax deferral, provided the application for deferral is filed before Brexit.
- To qualify for certain retirement plan benefits (i.e. allowances and tax benefits) under the "*Riester* scheme," certain condition must be fulfilled to withdraw amounts from the scheme before retirement age is reached. It generally is possible to invest the withdrawn funds into real estate for personal use without such an investment being considered harmful to a taxpayer's ability to benefit from preferential tax treatment for the contributions, as long as the real estate is located within the EU. The law clarifies that investments in real estate for personal use that are made before the effective date of Brexit will not constitute a harmful event and, therefore, will not affect the beneficial tax treatment under the scheme.

In addition to the measures included in the first draft of the law published by Germany's MOF, the final law includes the following measures:

- To prevent companies that are organized in the legal form of a UK company but that have their place of management in Germany ("private companies limited by shares" are a common type) from being treated as partnerships for German corporate income tax purposes after Brexit, a new provision will be introduced into the corporate income tax code providing that such UK companies will continue to be subject to corporate income tax. In addition, certain provisions will be introduced into the Real Estate Transfer Tax (RETT) Act to prevent RETT being triggered for these companies.
- An additional provision will be introduced into the Reorganization Tax Code to coordinate with certain transition periods granted in the Reorganization Act for mergers including a UK resident company. Under the provision, in these cases, the provisions in the Reorganization Tax Code that apply for EU resident companies still will be applicable to UK resident companies following Brexit.
- A provision will be introduced into the Estate Tax Act that will provide that certain tax benefits that are granted for estates located in the EU will continue to exist for estates located in the UK, provided the taxable event takes place before Brexit.

The law will become effective on 29 March 2019, after it is signed by the president and published in the federal gazette.

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